

Public Chapter 282, Acts of 1993 Definition of Business Earnings

Franchise, Excise taxes notice

Public Chapter 282 of the Public Acts of 1993, effective for tax years ending on or after July 15, 1993, amended Tenn. Code Ann. Section 67-4-804(a)(1). This amendment broadened the definition of business earnings for excise tax purposes.

As stated in the amendment, the legislative intent is to “tax entities which are subject to the Tennessee franchise, excise tax to the extent permitted under the state’s constitutional power to tax.” The provisions in the amendment “implement and clarify the distinctions between business and nonbusiness earnings as found in the Uniform Division of Income for Tax Purposes Act (UDITPA).”

Under UDITPA, income is business earnings if it meets one of two tests: transactional or functional. If the earnings arise from transactions and activity in the regular course of the taxpayer’s trade or business, the transactional test is met, and the income is business earnings. If the acquisition, use, management or disposition of the property giving rise to the income constitutes an integral part of the taxpayer’s regular trade or business operations, the functional test is met, and that income is business earnings.

The following examples are illustrative only and do not purport to set forth all pertinent facts.

1.) A taxpayer built a plant for use in its manufacturing business and 20 years later the plant was closed and put up for sale. The plant was rented for a temporary period from the time it was closed until it was sold 18 months later. The rental income is business income and the gain on the sale of the plant is business earnings.

2.) A machinery manufacturer transacts a complicated multi-million dollar deal to acquire the manufacturing assets of another business. As a result, the taxpayer becomes the owner of a 25-year lease of a small roadside market building in Tennessee for a monthly rental income of \$1,000. The taxpayer does not own any other property that it leases to others. The taxpayer did not set out to engage in the business of real estate rental. It became a lessor only as the result of a deal that enabled it to expand its manufacturing operations. The small roadside market and the resulting rental income are *de minimis* in relation to the taxpayer’s multi-million dollar manufacturing business and, thus, do not rise to the level of an additional business. The rental income is nonbusiness income.

3.) The taxpayer is engaged in a multi-state money order and traveler’s checks business. In addition to the fees received in connection with the sale of the money orders and traveler’s checks, the taxpayer earns interest income by the

investment of the funds pending their redemption. The interest income is business earnings.

4.) The taxpayer is engaged in the music publishing business and holds copyrights on numerous songs. The taxpayer acquires the assets of a smaller publishing company, including music copyrights. Any royalties received on these copyrights are business earnings.

5.) The taxpayer is engaged in manufacturing and wholesaling business. In connection with that business the taxpayer maintains special accounts for items such as workmen's compensation claims, etc. Some of the money in these accounts is invested in interest bearing bonds. The remainder is invested in various common stocks listed on national stock exchanges. Both the interest income and any dividends are business earnings.

6.) A taxpayer principally engaged in manufacturing has excess cash not needed for business operations which is

set aside in a portfolio and invested long term in stocks, bonds, etc. The company earns interest and dividends which are reinvested in the portfolio. Neither the portfolio investments nor the income earned thereon is used to support the manufacturing operations. The income earned is business earnings.

7.) Same as example 6, except the taxpayer sells stock from the portfolio which generates a gain. The gain is deemed business earnings.

Tenn. Comp. R. & Regs. 1320-6-1-.23 has not been amended since the 1993 law change. Taxpayers should exercise caution in relying on the examples of business/nonbusiness earnings set out in this Rule because they may no longer be valid after the change in the law.

Have questions or comments? Please let us know. [Contact us.](#)

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